

Supplemental Letter of Findings Number: 07-0327
Income Tax
For the Tax Years 2003-2004

NOTICE: Under [IC 4-22-7-7](#), this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

I. Exclusion of Taxpayer's Subsidiaries from Taxpayer's Consolidated Adjusted Gross Income Tax Return.

Authority: IC § 6-3-2-2(a); IC § 6-3-4-14(a); IC § 6-8.1-5-1(c); [45 IAC 3.1-1-38](#); [45 IAC 3.1-1-110](#); [45 IAC 3.1-1-111](#); 15 U.S.C. § 381; I.R.C. § 1504; *Enterprise Leasing Co. v. Indiana Dept. of State Revenue*, 779 N.E.2d 1284 (Ind. Tax Ct. 2002); *Wabash, Inc. v. Department of State Revenue*, 729 N.E.2d 620 (Ind. Tax Ct. 2000); *Wisconsin Dept. of Revenue v. William Wrigley, Jr.*, 505 U.S. 214, 112 S. Ct. 2447 (1992).

Taxpayer argues that the Department of Revenue (Department) erred when it excluded taxpayer's subsidiaries from taxpayer's consolidated adjusted gross income tax returns for the subject tax years. Taxpayer maintains that, by virtue of the subsidiaries' respective activities within the state, it has established an Indiana nexus and that the subsidiaries should have been included in the calculation of taxpayer's Indiana adjusted gross income.

STATEMENT OF FACTS

Taxpayer is a manufacturer of automobile and commercial vehicle auto parts and accessories, including steel and aluminum wheels, intake manifolds, and related engine covers and casing assemblies. Taxpayer submitted consolidated Indiana tax returns reporting its state income tax liabilities. Taxpayer's 2003 return included the operating results for a pair of subsidiaries with principal places of business located outside Indiana, hereinafter "Ohio Subsidiary" and "Transportation Subsidiary." Taxpayer's 2004 return included the operating results for the Ohio Subsidiary, as well as another subsidiary also with a principal place of business located outside Indiana (Commercial Subsidiary). The Department conducted an audit review of these returns, making a number of adjustments. Those adjustments included a determination that taxpayer's Ohio and Transportation Subsidiaries should not have been included in the 2003 consolidated return; and that taxpayer's Ohio and Commercial Subsidiaries should not have been included in the 2004 consolidated return. The decision to eliminate the respective subsidiaries resulted in an increase of taxpayer's state income tax liability. Taxpayer submitted a protest. In its protest letter, taxpayer did not contest the Department's exclusion of Transportation Subsidiary from the 2003 consolidated return, but protested the Department's exclusion of Ohio Subsidiary and Commercial Subsidiary from the consolidated returns for the respective tax years. The Department scheduled and notified taxpayer of an administrative hearing, but taxpayer chose not to attend the hearing. Taxpayer chose to base its position on the materials submitted prior to the hearing. The Department issued a Letter of Findings denying the taxpayer's protest.

Taxpayer requested a rehearing, which the Department granted. Additional facts will be supplied as necessary.

DISCUSSION

I. Exclusion of Taxpayer's Subsidiaries from Taxpayer's Consolidated Adjusted Gross Income Tax Return.

Taxpayer bases its protest on visits by select taxpayer employees to taxpayer's customers' facilities located in Indiana, asserting that such visits establish nexus in Indiana. Taxpayer also asserts that ownership of inventory and tooling residing in third party vendors' and suppliers' respective facilities located in Indiana establishes nexus in Indiana for the subject tax years.

In its protest, taxpayer stated that a pair of its employees traveled to two of taxpayer's customers' facilities located in Indiana to perform quality assurance services on behalf of the Ohio and Commercial Subsidiaries. Taxpayer included a copy of an affidavit signed by one of these employees attesting to "several trips" made to the customers' plants during the two subject tax years, along with copies of receipts indicating the attesting employee's payments for meals, lodging, and transportation-related expenses during two such trips made in 2003. Taxpayer asserted that these receipts "are just an example of the support retained from many of his trips." Taxpayer provided a second affidavit signed by one of the customers' employees attesting to services provided by the same pair of taxpayer's employees during the 2003 and 2004 tax years.

In support of its protest, taxpayer also provided copies of agendas for a pair of meetings occurring at one of the above-mentioned customers' facilities; only one of those agendas includes a year in the meeting date, although taxpayer provides a one-page email string suggesting that this agenda relates to a February 2003 meeting. Taxpayer submitted these materials to show participation by select taxpayer employees in meetings occurring in Indiana. Taxpayer did not provide additional documents expanding on these meetings or agenda, receipts corresponding to expenses associated with these meetings or trips, or documents evidencing other activities conducted in Indiana by, or on behalf of, either taxpayer or taxpayer's subsidiaries.

In the rehearing, taxpayer continued to assert nexus based upon trips to Indiana made by select taxpayer's employees. Taxpayer provided an affidavit signed by a third employee attesting to another of taxpayer's employee's trip to Indiana to attend a supplier conference. The affidavit includes a hotel receipt, and a gas receipt corresponding to this two-day visit. The employee also attests to a pair of short visits by select taxpayer employees, describing the employees as "attendees" to a pair of meetings held at one of taxpayer's customers' facilities on two separate occasions during the 2003 tax year. This affidavit does not include any expense reports or receipts corresponding to these visits or employees' attendance. Finally, the affiant employee describes a visit to Indiana by another of taxpayer's employees to a third-party tooling company to review machining processes. The affidavit includes taxpayer-produced expense reports, but does not include any receipts, corresponding to this visit.

Finally, taxpayer's protest singled out inventory and tooling owned by taxpayer used in third party vendors' and suppliers' sites located in Indiana. During the subject tax years, Ohio Subsidiary owned steel temporarily residing in Indiana valued at \$2.3 million; Commercial Subsidiary owned similar steel valued at \$10 million. Taxpayer asserted that its Indiana vendors and suppliers, acting as contract manufacturers, transformed steel owned by Ohio and Commercial Subsidiaries into a different form before taxpayer transported the changed steel to facilities in Tennessee. Taxpayer sold a "significant" portion of the finished goods back into Indiana. Taxpayer asserts that Ohio and Commercial Subsidiaries' ownership of inventory used in Indiana constitutes "doing business" in Indiana.

In the rehearing, taxpayer provided a second affidavit, signed by the same employee that had signed the other affidavit presented during the rehearing. This second affidavit provides limited additional information regarding the aforementioned inventory and tooling. This limited additional information does not clarify or contradict information provided to the Department during the Department's audit review.

Indiana Department of Revenue assessments are prima facie evidence that Department's claim for unpaid taxes is valid. IC § 6-8.1-5-1(c). The taxpayer has the burden of proving whether the Department incorrectly imposed the assessment. *Id.*

IC § 6-3-4-14(a) provides that "[a]n affiliated group of corporations shall have the privilege of filing a consolidated return with respect to the taxes imposed by [IC 6-3](#)."

The Department's regulation states that "[a]n affiliated group as defined in [IC 6-3-4-14\(b\)](#) may file consolidated returns for Adjusted Gross Income Tax and Supplemental Net Income Tax...." [45 IAC 3.1-1-110](#). [45 IAC 3.1-1-111](#) provides that "[t]he Adjusted Gross Income Tax Act adopts the definition of 'affiliated group' contained in Internal Revenue Code Section 1504, except that no member of the affiliated group may be included in the Indiana return unless it has adjusted gross income derived from sources within the state, as that phrase is defined in [IC 6-3-2-2](#)."

I.R.C. § 1504 defines, among other things, the degree of ownership which must exist before related businesses can be considered to be members of a federal "affiliated group."

However, qualifying under I.R.C. § 1504 – standing alone – is not sufficient to qualify the related businesses to file, or be included in, an Indiana consolidated tax return. In this situation, the Ohio and Commercial Subsidiaries must have received "adjusted gross income derived from sources with the state, as that phrase is defined in [IC 6-3-2-2](#)." [45 IAC 3.1-1-111](#).

IC § 6-3-2-2(a) provides as follows:

With regard to corporations and nonresident persons "adjusted gross income derived from sources with Indiana", for purposes of this article, shall mean and include:

- (1) income from real or tangible personal property located in this state;
- (2) income from doing business in this state;
- (3) income from a trade or profession conducted in this state;
- (4) compensation from a trade or profession conducted in this state; and
- (5) income from stocks, bonds, notes, bank deposits, patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other intangible personal property if the receipt from the intangible is attributable to Indiana under section 2.2 of this chapter.

The Department's regulation provides a definition for "doing business" within the state:

For apportionment purposes, a taxpayer is "doing business" in a state if it operates a business enterprise or activity in such a state including, but not limited to:

- (1) Maintenance of an office or other place of business in the state
- (2) Maintenance of an inventory of merchandise or material for sale distribution, or manufacture, or consigned goods
- (3) Sale or distribution of merchandise to customers in the state directly from company-owned or operated vehicles where title to the goods passes at the time of sale or distribution
- (4) Rendering services to customers in the state
- (5) Ownership, rental or operation of a business or of property (real or personal) in the state
- (6) Acceptance of orders in the state
- (7) Any other act in such state which exceeds the mere solicitation of orders so as to give the state nexus

under P.L. 86-272 to tax its net income.
[45 IAC 3.1-1-38.](#)

The provisions outlined in this regulation constitute a minimum threshold of activity in which an entity must engage to warrant inclusion in the Indiana consolidated return as activity sufficient to establish nexus with the state such that taxation would not be prohibited under P.L. 86-272. 15 U.S.C. § 381. The U.S. Supreme Court established that a de minimus [*sic*] amount of non-solicitation activity would not cause a corporation to lose the exemption from taxation afforded by P.L. 86-272. *Wisconsin Dept. of Revenue v. William Wrigley, Jr.*, 505 U.S. 214, 228-29, 112 S.Ct. 2447, 2456-57 (1992). The Court also stated that a company will lose the protection of P.L. 86-272 if it performs an activity that establishes a nontrivial additional connection with the taxing state. *Id.* at 231-32. The Indiana Supreme Court has stated that particular emphasis should be placed upon the totality of the business activities of a company within Indiana when interpreting P.L. 86-272. See *Wabash, Inc. v. Department of State Revenue*, 729 N.E.2d 620, 624 (Ind. Tax Ct. 2000)(citing *Indiana Dept. of Revenue v. Kimberly-Clark Corp.*, 416 N.E.2d 1264, 1268, 275 Ind. 378, 383 (Ind.1981)).

Taxpayer's Indiana contract manufacturer, vendors and suppliers—entities not owned by taxpayer or the Ohio or Commercial Subsidiaries—stored and processed inventory owned by the taxpayer. Contrary to the figures provided in taxpayer's protest, the Department's investigation documents the Ohio Subsidiary reporting approximately \$211,000 in tooling and inventory for the 2003 tax year, and \$88,000 for the 2004 tax year. Ohio Subsidiary's total property everywhere during these two tax years amounted to \$81,000,000 and \$37,000,000, respectively. Commercial Subsidiary reported approximately \$118,000 in Indiana property for 2004. Commercial Subsidiary's total property everywhere during 2004 amounted to \$25,000,000. Given the chance in both its protest submission and its rehearing, taxpayer did not provide additional documentation or information to contradict the Department's investigation; taxpayer included the Department's workpapers and explanation as exhibits in its protest, without copies of documents supporting its inventory valuation asserted in its protest. The second affidavit provided during the rehearing also did not include any documents supporting its valuation assertions.

While taxpayer provided an expense report and an additional set of receipts corresponding to another visit to a suppliers conference located in Indiana, along with expense reports corresponding to a visit by another of taxpayer's employees, taxpayer did not provide additional documents or information demonstrating routine or regularly scheduled presence by taxpayer's employees at the Indiana contract manufacturer's, vendors' and suppliers' facilities. Taxpayer's inventory enters Indiana temporarily, and is not held for sale. Neither Ohio Subsidiary nor Commercial Subsidiary maintained an office, leased property, held inventory for sale or had employees in Indiana during the subject tax years. During the subject tax years, neither Ohio Subsidiary's maintenance in Indiana of approximately two-tenths of one percent of its total property nor Commercial Subsidiary's maintenance in Indiana of approximately one-half of one percent of its total property represents activity sufficient to overcome the P.L. 86-272 exemption.

With respect to the presence of tooling owned by taxpayer in taxpayer's Indiana vendors and suppliers, taxpayer provided the tooling free of charge for use by the vendors and suppliers. The third party vendors and suppliers generate income from the use of the tooling, not the taxpayer. Property located in Indiana used by a third party is not business property includable in the numerator of the property factor of the owner of the property. See *Enterprise Leasing Co. v. Indiana Dept. of State Revenue*, 779 N.E.2d 1284, 1294 (Ind. Tax Ct. 2002).

In taxpayer's rehearing request, taxpayer cites various case law to accompany its statements regarding its alleged business activity in Indiana. But taxpayer failed to provide documents or information to contradict the Department's audit review, nor overcome the Department's Letter of Findings. Based upon the still limited information provided by the taxpayer and the information provided by the Department's investigation report, the taxpayer neither generates an income stream in Indiana nor has Indiana business activity associated with the tooling or the raw materials. Taxpayer's activity fails to establish a nontrivial connection with Indiana to overcome its exemption from taxation under P.L. 86-272 with respect to alleged activities by taxpayer's Ohio and Commercial Subsidiaries. Therefore, Ohio and Commercial Subsidiaries did not have income derived from Indiana sources within the meaning of IC § 6-3-2-2 and cannot be included in the taxpayer's Indiana consolidated return.

FINDING

Taxpayer's protest is respectfully denied.

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